


EP Phone Forum

Funding-Based Benefit Restrictions

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Topics covered


- Background
- Funding rules for single-employer plans
- Benefit restrictions

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Background


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Background

- Pre-PPA concerns about underfunded plans
 - Costs amortized over periods as long as 30 years
 - Too much difference between actuarial and market value of assets
 - Perceived abuses, assumptions and methods
 - Use of credit balances in underfunded plans
 - Plan amendments, large distributions exacerbate underfunding


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Background

- Congress' response (single-employer plans)
 - All costs amortized over 7 years
 - Restrictions on actuarial value of assets
 - One funding method
 - Mandated assumptions
 - Restrictions on use of credit balances
 - Expansion of deductible limits on contributions
 - Benefit restrictions


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Background

- WRERA changes
 - Technical corrections
 - Funding relief
- Pending pension legislation would provide temporary relief
 - Extension of time to amortize costs
 - Ease restrictions on actuarial value of assets
 - Lookback to determine whether credit balances can be used to offset MRC
 - Delay in applying certain benefit restrictions to collectively bargained plans


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Guidance issued:

- Proposed regulations, quarterly contributions
- Final regulations on sections 430 and 436
- Notice 2009-22 – interim guidance, actuarial value of assets
- Announcement 2009-97 – extension of time to amend plan for section 436
- Notice 2010-03 – automatic approval for certain changes in funding methods
- 2009 instructions, Schedule SB of Form 5500


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Guidance in progress

- Final regulations, section 430(a), 430(j) (including quarterly contributions)
- Proposed regulations, sections 430 and 436
 - WRERA changes
 - Issues that have not yet been available for public comment
- 101(j) notice

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Benefit restrictions

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Overview

- Compliance is qualification issue
- Compliance is fiduciary issue
- Provisions must be reflected in plan
- Restrictions based on funding level
- High-25 restriction still applies

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Overview

- Funding level based on AFTAP = Adjusted funded target attainment percentage
 - Actuary must certify based on actual valuation results as reported on Schedule SB
 - Based on assets reduced for credit balances
 - May need to recertify for subsequent changes
 - Final regulation expanded information required in certification


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Overview

- If AFTAP is:
 - 100% or over - no restrictions
 - Over 80% but under 100%
 - Restriction on accelerated benefits if plan sponsor in bankruptcy
 - 60% but not 80%
 - Partial restriction on accelerated benefits
 - Plan amendments cannot take effect


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Overview

- If AFTAP is:
 - Under 60%
 - No accelerated benefits paid
 - Accruals cease
 - No unpredictable contingent event benefits paid
 - No amendments even if make 436 contribution
 - WRERA change – use 2008 AFTAP if larger than 2009 when testing whether accruals continue


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Overview

- Before actual AFTAP available, can use
 - Presumed AFTAP
 - Range certification
- Presumed AFTAP (for calendar year plan)
 - January 1 – certified AFTAP for prior year
 - April 1 – generally decrease prior-year AFTAP by 10%
 - October 1 – conclusively presumed under 60% -- all restrictions apply


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Overview

- Range certification
 - Used before valuation results available, but actuary is certain of the range
 - Treated as actual certification – disqualification if range certification is wrong
 - Treated as lowest value in range
 - Must have actual certification by end of plan year or retroactively presumed under 60%


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Avoiding restrictions

- Elect to reduce credit balances
 - Works because assets are reduced by credit balances for AFTAP calculation
 - Deemed election (required) for
 - Restriction on accelerated distributions (all plans)
 - All restrictions for collectively bargained plans
 - But only applies if credit balances large enough to avoid restrictions
 - Collectively bargained if 25% participants or 50% employees covered by plan are covered by CBA
 - Voluntary reduction for other restrictions


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Avoiding restrictions

- Example
 - Assets = \$90,000
 - Carryover balance = \$10,000
 - Prefunding balance = \$10,000
 - Funding target = \$100,000
 - Annuity purchases = \$0
- Funding ratio for benefit restrictions (AFTAP)
 - Assets are reduced by both credit balances
 - Reduced assets = \$90,000 - \$20,000 = \$70,000
 - Funding target = \$100,000
 - AFTAP = \$70,000 / \$100,000 = 70%

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Avoiding restrictions

- If plan sponsor elects to reduce COB by \$10,000
 - Reduced assets = \$90,000 - \$10,000 = \$80,000
 - Funding target = \$100,000
 - AFTAP = \$80,000 / \$100,000 = 80%

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Avoiding restrictions

- Reduction in credit balances can affect minimum funding requirements
 - Affects calculation of MRC
 - Amount waived is not available to offset MRC
 - Reduction deemed to occur on first day of plan year – may retroactively “trump” amounts used to offset quarterly installments
 - Need to consider implications

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Avoiding restrictions

- Increase AFTAP by making additional prior-year contributions
- “Section 436” contributions
 - Not available to avoid restrictions on accelerated distributions
 - Cannot count toward MRC
 - Cannot use credit balances
- Post security by valuation date

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UCEB restriction

- Applies to plant shutdown benefits, other unpredictable contingent event benefits
 - Applies based on AFTAP at time of event
 - Applies on participant-by-participant basis
 - If permitted later in plan year, additional benefits automatically paid
- Section 436 contribution depends on AFTAP before event
 - If under 60% - cost of additional benefits
 - If over 60% -- amount needed for 60% AFTAP

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Restriction on plan amendments

- Applies when amendment affects plan operation
- If permitted later in plan year, amendment automatically takes effect
- Limited exception for amendments not based on compensation
- Section 436 contribution depends on AFTAP before amendment
 - If under 80% - full cost of amendment
 - If over 80% - amount needed for 80% AFTAP
 - Not available if AFTAP under 60% (frozen accruals)

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Restriction on accelerated distributions

- Applies at annuity starting date
- Presumed AFTAP doesn't count if sponsor is in bankruptcy – need actual certification
- WRERA exception for automatic cashouts


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Restriction on accelerated distributions

- Partial restriction
 - Applies to ½ benefit or PBGC guaranteed benefit if less
- Mandatory options
 - Bifurcate benefit
 - Defer benefit
 - Elect unrestricted option
- Voluntary options
 - Defer restricted portion of bifurcated benefit
 - Additional optional forms of payment available only when restrictions apply


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Restriction on accelerated distributions

- Bifurcation of benefits
 - Based on PV of total distribution
 - Apply minimum present value rules separately to each portion
 - Special rules for Social Security leveling option
- Plan termination
 - Restrictions continue to apply after termination
 - Exception for distributions made to complete standard termination


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Benefit accrual freeze

- Applies when AFTAP under 60%
- 436 contribution is amount needed for 60% AFTAP
- WRERA "lookback" rule
- Restoration of missed accruals if:
 - Plan language provides for automatic restoration
 - AFTAP is at least 60% including cost of restored accruals
 - Freeze in effect no more than 12 months
- Otherwise, restoration treated as amendment (80% threshold)


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Changes in AFTAP

- Material changes
 - Change operation of plan
 - Revert to presumed AFTAP
 - Possible disqualification
- Exceptions
 - Additional contributions
 - Election to reduce or apply credit balances
 - Subsequent plan amendments or UCE
 - Assumption or method changes requiring IRS approval (after approval granted)


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Recertification of AFTAP

- Actuary must recertify AFTAP if subsequent changes
 - If material change – including effect on next year's presumed AFTAP
 - If would be material but for exception
 - If 436 contribution to bring AFTAP to 60% or 80%
- Can recertify even if not required
- Must reflect any amendments, UCEB, 436 contributions after previous certification


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Changes in presumed AFTAP

- Presumed AFTAP based on prior-year AFTAP
- Modify presumed AFTAP if
 - Election or deemed election to reduce credit balances
 - 436 contribution to increase AFTAP to 80% (amendments) or 60% (UCEB, benefit accruals)
- No modification for
 - UCEB or amendments permitted to take effect automatically
 - Section 436 contributions to pay full cost of amendment or UCEB
 - Voluntary reductions in credit balances that don't result in removal of restrictions


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Inclusive presumed AFTAP

- Used to test whether plan amendment or UCEB is restricted
- Reflects:
 - Cost of current and prior plan amendments and UCEBs and
 - Any prior-year 430 and current-year 436 contributions made through effective date of amendment or UCEB,
 - Even if not in modified presumed AFTAP


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Section 436 implications

- Section 436 affects:
 - Plan administration
 - Document language
 - Collective bargaining
 - Employee communications


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Section 436 implications

- Plan administration
 - Coordination between plan sponsor, actuary, administrator
 - Need advance game plan
 - Communicate expected timing and effect of certification
 - Make tentative decisions


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Section 436 implications

- Plan administration
 - Conform systems
 - Adapt programming to restrict affected benefits
 - Calculate restricted/ unrestricted portions if applicable
 - Calculate benefits, any special optional forms available when restrictions apply
 - Election forms
 - Employee notices


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Section 436 implications

- Plan drafting
 - Document must reflect 436 restrictions
 - Must be definitely determinable
 - Must specify options when partial restrictions apply
 - Does not have to specify whether plan sponsor will take steps to avoid restrictions
 - Per Announcement 2009-97 not required until end of plan year beginning in 2010


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Section 436 implications

- Plan drafting
 - May provide for automatic restoration of missed accruals
 - If not specified in plan, must follow amendment rules based on 80% AFTAP
 - If specified in plan, may restore up to 12 months' accruals
 - Cannot generally restrict benefits more than required by law – 411(d)(6) violation


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Section 436 implications

- Collective bargaining
 - Perceived “gotcha” if negotiated increases don’t take effect
 - Required reduction of credit balances if large enough to avoid restriction
 - But 436 contributions voluntary


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Section 436 implications

- Collective bargaining
 - May see bargaining agreements with:
 - Funding commitments
 - Amendments with “spring-back” provisions if prevented from taking effect
 - Alternate arrangements for restricted benefits


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Section 436 implications

- Employee communications
 - General caveat, possibility of restrictions
 - Notice when restrictions apply
 - No guidance yet – might include:
 - Description of restriction and how it will affect specific benefits
 - Options available to employee – especially when bifurcation applies
 - Effective date of restriction, conditions under which it would be lifted

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Section 436 implications


- Employee communications
 - Election forms -- options
 - Reflect no restrictions – require another election if restrictions apply to elected form
 - Provide regular and “back-up” election if restrictions apply
 - Reflect current restrictions, permit another election if restrictions change
 - Implications for descriptions, calculation of amounts under optional forms of payment, relative value disclosures

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Funding rules


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Funding rules – single-employer plans

- Simplified in many ways
 - One actuarial cost method
 - One amortization period
 - Fewer choices, actuarial assumptions
- But will require more involvement of plan sponsor
- Elections are generally irrevocable for plan year
- May require IRS approval to change in future years


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Miscellaneous changes – final regulations

- Change allocation of certain benefits - tends to decrease funding target
- Clarify effect of 436 restrictions on funding target
- Allow replenishment of credit balance
- Clarify ordering rules, use of credit balances


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Plan sponsor elections – interest rates

- Interest rate assumptions
 - Minimum funding requirements no longer based on single interest rate
 - Use yield curve concept
- Default
 - Segment rates (simplified yield curve, 3 interest rates)
 - No lookback
 - Transition rule for 2008-2010


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Plan sponsor elections – interest rates

- Optional interest rates
 - Full yield curve
 - Segment rates
 - Lookback up to 4 months
 - Transition rule
- Interest rate assumptions
 - Generally need IRS approval to change election
 - Exceptions
 - 2008 – 2010 plan years
 - First election away from default


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Plan sponsor elections – interest rates

- Making interest rate election
 - No specific format or deadline
 - Written notification to enrolled actuary
 - Must be established before Schedule SB filed
 - May need to elect earlier to avoid material change in AFTAP


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Plan sponsor elections – credit balances

- Before PPA
 - One credit balance
 - Automatically used toward minimum funding requirements (including quarterly contributions)
 - Automatically increased with excess contributions
 - No ability (or need) to reduce credit balances


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Plan sponsor elections – credit balances

- After PPA
 - Two credit balances
 - Pre-PPA – Carryforward balance (COB)
 - Post-PPA – Prefunding balance (PFB)
 - Credit balance cannot be used to offset MRC unless plan is at least 80% funded
 - Elections are required to:
 - Use credit balances to offset minimum required contribution
 - Add excess contributions to prefunding balance
 - Reduce credit balance


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Plan sponsor elections – credit balances

- Assets are reduced by one or both credit balances when calculating key measures
 - Decision to reduce or use credit balances can affect calculation of MRC
 - Change in election may mean
 - Retroactive change in valuation results
 - Late / unpaid quarterly contributions


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Plan sponsor elections – credit balances

- Standing elections
 - Use credit balances to offset MRC
 - Not available for quarterly installments
 - Add excess contributions to PFB
 - Effective on last day for making specific elections
 - Remain in effect until
 - Revoked in writing to enrolled actuary
 - Actuary signing Schedule SB is not actuary named in election


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Plan sponsor elections – credit balances

- No specific format
- Must include specific amounts involved (other than standing elections)
- Must be provided in writing to enrolled actuary and plan administrator
- Generally irrevocable
 - May revoke “use” election if amount greater than full MRC
 - Standing election may be revoked before date deemed effective

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Plan sponsor elections – credit balances

- Timing of elections
 - No earlier than first day of plan year (except for standing elections)
 - “Use” election –
 - No later than deadline for contributing MRC
 - May need to elect earlier to cover quarterly installment
 - “Reduction” election – last day of plan year
 - Election to add excess contributions to PFB – deadline for contributing MRC

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Plan sponsor elections – credit balances

- Timing of elections
 - Election to revoke “use” election in excess of MRC
 - If valuation date is first day of plan year – end of plan year
 - Otherwise, due date for contributing MRC
 - Standing election
 - No later than deadline for contributing MRC
 - Replacement election (for change in actuary) – due date for filing Schedule SB

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Questions?

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